



LIBRARY OF CONGRESS

Copyright Office

[Docket No. 2013-4]

Review of Copyright Royalty Judges Determination

AGENCY: U. S. Copyright Office, Library of Congress.

ACTION: Notice.

SUMMARY: The Register of Copyrights issues the following decision identifying and correcting an erroneous resolution of a material question of substantive law under title 17 that underlies or is contained in the Copyright Royalty Judges' final determination of rates and terms of royalty payments for the use of sound recordings in transmissions made by Preexisting Subscription Services.

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SUPPLEMENTARY INFORMATION:

Background

The Copyright Royalty Judges ("CRJs"), who constitute the Copyright Royalty Board ("CRB"), are required by 17 U.S.C. 803(b) to issue determinations of rates and terms for royalty payments due for the public performance of sound recordings in certain digital transmissions by licensees, including Preexisting Subscription Services ("PSS") and Satellite Digital Audio Radio Services ("SDARS"), in accordance with the provisions of 17 U.S.C. 114 and 112(e). Pursuant to 17 U.S.C. 801(b)(1), the rates applicable to

PSS and SDARS are to be reasonable and shall be calculated by the CRJs to achieve the following objectives:

- A) To maximize the availability of creative works to the public.
- B) To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions.
- C) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, risk, and contribution to the opening of new markets for creative expression and media for their communication.
- D) To minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.

17 U.S.C. 801(b)(1); *see also* 17 U.S.C. 114(f)(1)(B) (specifying that CRJs shall consider factors set forth in section 801(b)(1) in establishing rates for PSS and SDARS).

On February 14, 2013, the CRJs issued a final determination of rates and terms of royalty payments for the use of sound recordings in transmissions made by PSS and SDARS (“Final Determination”). For PSS, for the period 2013 through the end of 2017, the CRJs established a phased-in royalty rate commencing at 8.0% of gross revenues and rising to 8.5% in 2014. For SDARS, the CRJs established a phased-in rate commencing at 9.0% gross revenues and escalating to 11.0% by 2017.

Under 17 U.S.C. 802(f)(1)(D), the Register of Copyrights may review for legal error the resolution by the CRJs of a material question of substantive law under title 17 that underlies or is contained in a final determination of the CRJs. If the Register of Copyrights concludes, after taking into consideration the views of the participants in the proceeding, that any resolution reached by the CRJs was in material error, the Register of Copyrights shall issue a written decision correcting such legal error. 17 U.S.C.

802(f)(1)(D). The Register’s correction, which must specifically identify the legal conclusion of the CRJs determined to be erroneous, is to be published in the Federal Register along with the CRJs’ final determination. *Id.* “As to conclusions of substantive law involving an interpretation of the statutory provisions of [title 17], the decision of the Register of Copyrights shall be binding as precedent upon the Copyright Royalty Judges in subsequent proceedings” *Id.*

The Register concludes that the CRJs’ determination of rates for royalty payments to be paid by PSS pursuant to 17 U.S.C. 114 for the use of sound recordings did not properly consider the four statutory factors as required under 17 U.S.C. 801(b)(1). The CRJs’ misinterpretation of the applicable statutory standard constitutes an erroneous resolution of a material question of substantive law under title 17 that underlies or is contained in the final determination.

Copyright Royalty Judges’ Determination Setting Rates and Terms for Preexisting Subscription Services

On January 5, 2011, the CRJs announced the commencement of proceeding 2011-1 CRB PSS/Satellite II (“PSS SDARS II”) to determine the reasonable rates and terms applicable to PSS and SDARS for the period January 1, 2013 through December 31, 2017. 76 FR 591, Jan. 5, 2011. Pursuant to 17 U.S.C. 804(b)(3)(B), the CRJs gave notice of a request for petitions to participate. *Id.* By the time of the commencement of the PSS SDARS hearing, of the original participants, only Music Choice, Sound Exchange, and Sirius XM remained as non-settling participants in the proceeding. Final Determination at 2. On May 25, 2012, these participants submitted a stipulation to the CRJs in which they agreed to § 112 license rates and terms, and the proceeding continued with respect to

the § 114 rates and terms. *Id.* at 2. On December 14, 2012, the CRJs issued their Initial Determination in the proceeding. *Id.* at 3. SoundExchange and Sirius XM filed motions for a rehearing asserting various errors of fact and law, both of which were denied on January 30, 2013. Order Denying Motions for Rehearing, Docket No. 2011-1 CRB PSS/Satellite II (Jan. 30, 2013). On February 14, 2013, the CRJs issued their Final Determination of rates and terms for PSS and SDARS.¹

This review concerns the CRJs' interpretation and application of the statutory criteria of § 801(b)(1) in establishing rates for PSS, which involved the participants Music Choice and SoundExchange.² As set forth above, under 17 U.S.C. 801(b)(1), the rates established for PSS under section 114(f)(1)(B) are to be reasonable and calculated to achieve each of four statutory objectives. 17 U.S.C. 801(b)(1); *see also* 17 U.S.C. 114(f)(1)(B) (specifying that CRJs shall consider factors set forth in § 801(b)(1) in establishing rates for PSS and SDARS); *accord SoundExchange, Inc. v. Librarian of Congress*, 571 F.3d 1220, 1222 (D.C. Cir. 2009) (setting forth statutory standard).

In the proceeding, Music Choice proposed a PSS royalty rate of 2.6% of gross revenues. Final Determination at 9. SoundExchange, for its part, proposed a rate of 15% of gross revenues for the first year of the licensing period, increasing to 45% by 2017. *Id.* The CRJs concluded that these proposals "were so far apart, and so far from the current rate, that they cannot even be said to describe a 'zone of reasonableness.'" *Id.* at 16. In light of this assessment, the CRJs determined that "[t]he only remaining guidance the Judges have upon which to base the new rates is the current royalty rate of 7.5% of PSS

¹ The Final Determination reflected the views of two of the three CRJs. The third CRJ, Judge Roberts, filed a separate opinion concurring in part and dissenting in part. In referencing the "CRJs" in the course of discussing the majority opinion, the Register is referring to the two majority judges.

² Sirius XM participated in proceeding only with respect to rates for SDARS.

Gross Revenues. This rate approximates the middle of the wide spectrum proposed by the parties. It is the rate against which the Judges will test the section 801(b) policy factors.” *Id.* at 16-17.³

This approach stands in contrast to the CRJs’ methodology in the previous PSS SDARS proceeding (“PSS SDARS I”), as well as in the SDARS portion of the instant proceeding, pursuant to which the CRJs applied the statutory factors to a range of potentially applicable rates determined to lie within the “zone of reasonableness” in order to ascertain which rates among those considered should be adopted. *See* 73 FR 4080, 4094-98, Jan. 24, 2008 (identifying 2.35% to 13% as the zone of reasonableness and applying the statutory factors to adopt rates within that zone); Final Determination at 49-62 (analyzing SDARS rates within a “zone of reasonableness”).⁴ As this process has been explained by the Court of Appeals for the D.C. Circuit, “To the extent that the statutory objectives determine a range of reasonable royalty rates that would serve all [the] objectives adequately but to differing degrees, the [Board] is free to choose among those rates, and courts are without authority to set aside the particular rate chosen by the

³ At a different point in the opinion, the CRJs observed that the benchmark evidence submitted by the PSS parties in support of their proposals, which included licensing agreements with various third parties and expert analysis thereof, “failed to provide the means for determining a reasonable rate for the PSS, other than, perhaps to indicate the extreme ends of the range of reasonable rates.” Final Determination at 20. This statement appears to contradict somewhat the CRJs’ earlier conclusion, described above, that the parties had failed to establish any zone of reasonableness whatsoever. What is clear, however, is that in applying the § 801(b)(1) factors, the CRJs did not consider a range of 2.6% to 15%, or any other range of possible rates, but instead assessed only the singular rate of 7.5% under each of the four statutory factors. *See Id.* at 20-29.

⁴ In its motion for rehearing, SoundExchange took issue with the way in which the CRJs defined the zone of reasonable rates for SDARS, as the Final Determination appears to suggest two possible ranges. *Compare* Final Determination at 48-49 (suggesting zone was 7% to 22.32%), with Final Determination at 61 (suggesting 12%-13% as the top of the zone of reasonableness). In rejecting SoundExchange’s motion, the CRJs stated that “the Judges determined that the zone of reasonableness had a floor of 7% . . . and an upper bound ‘that can be no more than 22.32%.’” Order Denying Motions for Rehearing at 3. The rates established by the CRJs for SDARS after considering the statutory factors fell within both possible zones. Final Determination at 68.

[Board] if it lies within a zone of reasonableness.” *Recording Indus. Ass’n v. Librarian of Congress*, 608 F.3d 861, 865 (D.C. Cir. 2010) (alterations in original).⁵

Here, instead of analyzing a range of potentially acceptable rates for PSS under the section 801(b)(1) factors, the CRJs instead chose to apply the four statutory objectives to only the existing statutory rate of 7.5%. In the case of the first section 801(b) factor – maximizing the availability of creative works – the CRJs determined that “the policy goal of maximizing creative works to the public is reasonably reflected in the current rate and, therefore, no adjustment is necessary.” Final Determination at 22. With respect to the second factor, however – affording fair return/fair income to copyright owners and users – the CRJs concluded, in light of a prospective increase in Music Choice’s usage of sound recordings, that “a 1% upward adjustment of the benchmark (from 7.5% to 8.5% of *Gross Revenues*), phased in during the early part of the licensing period, is appropriate to serve the policy of fair return/fair income.” *Id.* at 25. Turning to the third factor – the relative roles of copyright owners and users – the CRJs reverted to the 7.5% rate, opining that “[u]pon careful weighing of the evidence . . . no adjustment [to the current 7.5% rate] is warranted.” *Id.* at 27. With respect to the fourth factor – minimizing disruptive impact – “the Judges [were] not persuaded by the record testimony or the arguments of the parties that the current PSS rate [of 7.5%] is disruptive to a degree that would warrant an adjustment, either up or down.” *Id.* at 29.

In sum, the CRJs’ analysis yielded conflicting results. An upward adjustment to the current 7.5% rate was found to be warranted under factor two, while factors one, three

⁵ The Register does not mean to suggest that there is only one conceivable approach to satisfy the statutory criteria, but merely to point out an established methodology for testing potential rates against the section 801(b)(1) factors. *Cf.* Mechanical and Digital Phonorecord Rate Determination Proceeding, 74 FR 4510, 4522-26, Jan. 26, 2009 (considering specific penny rates for the reproduction and distribution of musical works under section 801(b)(1) and finding that such rates satisfied all four factors without any need for adjustment).

and four indicated that the rate should remain the same. Following this mixed review of the 7.5% rate under the statutory factors, the CRJs – without any explanation of how these disparate results might be reconciled – chose to adopt a “phased-in” rate structure starting at 8.0% in 2013, and increasing to 8.5% for the years 2014 through 2017. *Id.*⁶

On March 15, 2013, the Copyright Office issued a Notice of Review for Legal Error in Docket No. 2011-1 CRB (“Notice”). In the Notice, the Office sought comments, *inter alia*, on whether the PSS rates in the final determination “were properly evaluated under each of the four statutory objectives as required by 17 U.S.C. 801(b)(1).” Notice at 2; 17 U.S.C. 802(f)(1)(D) (in conducting review for legal error, Register is to take into account the views of the participants).⁷

The Office received responses to this question from the two interested parties, Music Choice and SoundExchange.⁸ In its comments, Music Choice asserted that because the CRJs had erroneously selected 7.5% from the PSS SDARS I determination as the benchmark rate for their consideration, the evaluation of the four policy objectives based on this selection was also necessarily erroneous. Letter from Paul M. Fakler to Office of the General Counsel at 12 (Mar. 22, 2013). Music Choice observed that “[i]n taking this approach, the Judges departed from longstanding precedent, in which a range of reasonable rates is established and then a rate is selected from within that range by balancing the four policy objectives” *Id.* (citing Librarian’s PSS Determination, 63 FR 25394, 25405-06, May 8, 1998).

⁶ The phase-in was designed to “moderate any potential negative impact the rate increase might have on the PSS.” Final Determination at 29.

⁷ The Register’s Notice posed additional questions to the participants. With regard to those additional questions, the Register has closed her review for legal error without reaching any conclusions. No inferences or precedential value shall be drawn from the Register’s decision to not to express any conclusions on those questions.

⁸ Sirius XM responded to the Notice but did not weigh in on the PSS issue.

In similar fashion, SoundExchange argued that applying the statutory factors to the “incorrect starting point” of the 7.5% rate established in PSS SDARS I was “utterly meaningless.” Letter from Michael B. DeSanctis to Office of the General Counsel at 5 (Mar. 25, 2013). As expressed by SoundExchange: “Simply put, it is a clearly erroneous application of the section 801(b)(1) factors to apply them as adjustments to a rate that is not a marketplace rate and that is wholly unsupported by the record evidence.” *Id.*⁹

Review of Copyright Royalty Judges’ Determination

Section 801(b)(1) provides that the rates adopted by the CRJs “shall be calculated to achieve” the four statutory objectives. Under a plain reading of the statutory provision, the rates selected by the CRJs must be determined to satisfy each of the four criteria in order to fulfill the statutory purpose.

As interpreted by the Court of Appeals for the District of Columbia Circuit, “the natural reading of the language of section 801(b)(1) is that the royalty rate is to be ‘calculated to achieve the following objectives’ in the sense of being designed or adapted for the achievement of those objectives” *Recording Indus. Ass’n v. Copyright Royalty Tribunal*, 662 F.2d 1, 8 n.19 (D.C. Cir. 1981). That court has further explained that “[t]he statutory factors pull in opposing directions, and reconciliation of these objectives is committed to the Tribunal [now CRB] as part of its mandate to determine ‘reasonable’ royalty rates.” *Id.* at 9.; *see also Recording Indus. Ass’n v. Librarian of Congress*, 608 F.3d at 864 (“When establishing terms and rates . . . the Copyright Act requires the Board to balance four general and sometimes conflicting policy objectives.”);

⁹ Although in their comments the responding parties expressed significant concern about the CRJs’ selection of the PSS statutory rate generated by PSS SDARS I as the relevant benchmark for PSS SDARS II, the Register does not mean to suggest any view on this aspect of the proceeding, or on the merits of the rates ultimately selected by the CRJs.

Recording Indus. Ass’n v. Librarian of Congress, 176 F.3d 528, 533 (D.C. Cir. 1999)

(“‘[R]easonable rates’ are those that are calculated with reference to the four statutory criteria.”).

Accordingly, in prior rate proceedings governed by section 801(b)(1), the CRJs (and their predecessor ratesetting bodies, the Copyright Royalty Tribunal and the copyright arbitration royalty panels) have assessed potentially applicable rates *including the ultimately selected rates* under each of the four statutory factors to ensure that the chosen rates would achieve the four policy objectives. *See, e.g.*, Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, 73 FR 4094-4098, Jan. 24, 2008; Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings, 63 FR 25405-09, May 8, 1998; Adjustment of Royalty Payable Under Compulsory License for Making and Distributing Phonorecords 46 FR 10466, 10479-81, Feb. 3, 1981; Adjustment of the Royalty Rate for Coin-Operated Phonorecord Players, 46 FR 884, 889, Jan. 5, 1981.

In this case the CRJs did not do this.¹⁰ Rather, in the instant proceeding, the existing statutory rate of 7.5% for PSS was found by the CRJs to meet the factors set forth in § 801(b)(1)(A), (C) and (D), with no adjustment warranted. But the CRJs also determined that the 7.5% rate should be adjusted upward for the period in question (initially to 8.0% and later to 8.5%) in light of the fair return/fair income factor set forth

¹⁰ Under the statutory framework, the CRJs are required to “act in accordance with regulations issued by the Copyright Royalty Judges and the Librarian of Congress, and on the basis of a written record, prior determinations and interpretations of the Copyright Royalty Tribunal, Librarian of Congress, the Register of Copyrights, copyright arbitration royalty panels (to the extent those determinations are not inconsistent with a decision of the Librarian of Congress or the Register of Copyrights), and the Copyright Royalty Judges (to the extent those determinations are not inconsistent with a decision of the Register of Copyrights that was timely delivered to the Copyright Royalty Judges pursuant to section 802 (f)(1)(A) or (B), or with a decision of the Register of Copyrights pursuant to section 802 (f)(1)(D)) . . . and decisions of the court of appeals” 17 U.S.C. 803(a)(1).

in section 801(b)(1)(B). Thus, the CRJs did not consider the ultimately selected rates of 8.0% and 8.5% against the policy goals of section 801(b)(1)(A), (C) or (D), or determine that the chosen rates in fact fulfill these three policy objectives.

Proper consideration of the four statutory criteria set forth in section 801(b)(1) lies at the heart of the process for establishing reasonable rates according to Congress' design. The Register therefore concludes that the CRJs' misinterpretation of section 801(b)(1), and consequent failure to evaluate the actual rates chosen for PSS under each of the section 801(b)(1) factors, constitutes a material error of substantive law.

CRJs' Continuing Jurisdiction

The Register notes that the CRJs enjoy continuing jurisdiction to amend their final determination. Under section 803(c)(4), "The Copyright Royalty Judges may issue an amendment to a written determination to correct any technical or clerical errors in the determination or to modify the terms, but not the rates, of royalty payments in response to unforeseen circumstances that would frustrate the proper implementation of such determination. Such amendment shall be set forth in a written addendum to the determination that shall be distributed to the participants of the proceeding and shall be published in the Federal Register." The Register encourages the CRJs to consider whether the error identified herein is amenable to correction pursuant to their continuing jurisdiction.

Conclusion

Having reviewed the resolution by the Copyright Royalty Judges for legal error, the Register of Copyrights hereby concludes that the rates set for royalty payments for the use of sound recordings in transmissions made by PSS must be found to satisfy all of the

section 801(b)(1) factors. The CRJs' failure to determine that the selected rates fulfill each of the four statutory objectives constitutes legal error. This decision shall be binding as precedent upon the CRJs.

Dated: April 9, 2013

Maria A Pallante
Register of Copyrights

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